

Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 ISO-00 FEA-01 ERDA-05 AID-05 CEA-01

CIAE-00 CIEP-01 COME-00 DODE-00 FPC-01 H-02 INR-07

INT-05 L-02 NSAE-00 NSC-05 OMB-01 PM-03 SAM-01 OES-03

SP-02 SS-15 STR-04 TRSE-00 FRB-03 PA-01 USIA-06

PRS-01 /095 W

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P 172010Z APR 75

FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC PRIORITY 6171

C O N F I D E N T I A L SECTION 1 OF 2 OTTAWA 1394

E.O. 11652: GDS

TAGS: ENRG, CA, US

SUBJ: FIRST MINISTERS' ENERGY CONFERENCE: PROSPECTS AND
IMPLICATIONS FOR U.S. OF CANADIAN OIL AND GAS
PRICE ISSUES

REF: OTTAWA 1332

POUCHED TO ALL CONSULATES IN CANADA FOR INFO

1. SUMMARY. THERE WILL BE SUBSTANTIAL INCREASE IN 1975 IN
PRICE OF NATURAL GAS FOR BOTH DOMESTIC AND EXPORT
CUSTOMERS. IT IS ALSO LIKELY THAT THE WELLHEAD PRICE OF OIL
WILL INCREASE. CONSENSUS ON PRICE RISES IN BOTH COMMODITIES
WILL BE SUBJECT IN FIRST INSTANCE TO FEDERAL/PROVINCIAL BI-
LATERAL NEGOTIATIONS; FAILING THAT THE GOC WILL BE EMPOWERED
TO TAKE UNILATERAL ACTION ON DOMESTIC PRICES ONCE PASSAGE OF
PETROLEUM ADMINISTRATION ACT IS ACHIEVED. FOR THE U.S.,
THE PRICE OF NATURAL GAS MAY RISE TO AS HIGH AS \$1.50 OR MORE
PER MCF ON AUGUST 1 AND MAY ALSO BE ACCOMPANIED
BY SUPPLY CURTAILMENTS. END SUMMARY.

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2. AS WAS APPARENT EVEN BEFORE THE CONVENING IN OTTAWA

OF THE FIRST MINISTERS' CONFERENCE APRIL 9 AND 10, THERE IS LIKELY TO BE A SUBSTANTIAL INCREASE IN THE PRICE OF OIL IN CANADA THIS YEAR AND THERE CERTAINLY WILL BE ONE IN THE PRICE OF NATURAL GAS. ON THIS, BOTH THE FEDERAL GOVERNMENT AND THE PRODUCING PROVINCES (ALBERTA, SASKATCHEWAN AND B.C.) APPEAR IN RARE AGREEMENT. THE REMAINING UNANSWERED QUESTIONS RELATE TO THE SIZES OF THE INCREASES, THE TIMING, THE TREATMENT ACCORDED DOMESTIC AS OPPOSED TO EXPORT CUSTOMERS, AND THE METHOD OF IMPLEMENTATION, I.E., WHETHER BY CONSENSUS ACHIEVED BY THE GOC IN TILATERAL TALKS WITH PROVINCES (WITH OR WITHOUT THE NECESSITY OF A FURTHER PRIVATE MEETING OF FIRST MINISTERS IN OTTAWA) OR BY FEDERAL FIAT AS WOULD BE POSSIBLE WHEN THE NATIONAL PETROLEUM ADMINISTRATION ACT (BILL C-32) IS ENACTED BY PARLIAMENT.

3. OIL: THE PRODUCING PROVINCES (ALBERTA AND SASKATCHEWAN) ARE EXPECTED TO CONTINUE TO HONOR THE \$6.50 PER BARREL WELLHEAD PRICE AGREEMENT REACHED IN MARCH 1974 UNTIL THE AGREEMENT OFFICIALLY TERMINATES ON JUNE 30. ALBERTA PREMIER LUGHEED HAS PUBLICLY STATED THAT THIS IS HIS PROVINCE'S INTENTION ALTHOUGH BOTH HE AND SASKATCHEWAN PREMIER BLAKENEY CONSIDER THAT OTTAWA BROKE THE 1974 AGREEMENT WHEN THE NOVEMBER FEDERAL BUDGET FORBADE THE DEDUCTION OF ROYALTY PAYMENTS TO THE PROVINCES BY THE PRODUCING COMPANIES IN CALCULATING THEIR FEDERAL CORPORATE INCOME TAX LIABILITIES. FURTHERMORE, LUGHEED, AT LEAST, HAS INDICATED THE POSSIBILITY OF MAINTAINING THE EXISTING PRICE SOMEWHAT BEYOND JULY 1 IF IT BECOMES APPARENT THAT A NATIONAL CONSENSUS ON A PRICE INCREASE IS CLOSE TO FRUITION. MINISTER MACDONALD, ON THE OTHER HAND, REPORTEDLY TOLD A TORONTO STAR INTERVIEWER (APRIL 15 ISSUES) THAT GOC IS PREPARED TO SEE OIL PRICES REMAIN AT PRESENT LEVEL FOR REMAINDER OF 1975 IF AGREEMENT WITH PROVINCES CANNOT BE REACHED.

4. AN OIL PRICE INCREASE, WHEN IT COMES, WILL LIKELY BE TO ABOUT \$8.50 PER BARREL, BUT PROBABLY NO HIGHER IN VIEW OF ONE "CONSENSUS" AT THE CONFERENCE THAT CANADIAN PRICES SHOULD NOT RPT NOT EXCEED THE CONFIDENTIAL

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AVERAGE U.S. PRICE OF OIL AND SHOULD BE SET AT A LEVEL WHICH WOULD MAINTAIN SOME MODICUM OF COMPETITIVE EDGE FOR CANADIAN MANUFACTURERS AND TRADERS OVER THEIR AMERICAN COMPETITORS. AN INCREASE IN THE WELLHEAD PRICE WOULD LOWER THE OIL EXPORT CHARGE BY AT LEAST AN EQUIVALENT AMOUNT (THIS, OF COURSE, WOULD NOT RPT NOT LOWER THE OVERALL COST OF CANADIAN OIL TO U.S. IMPORTERS) AND DECREASE SIMULTANEOUSLY THE PAYMENTS TO

EASTERN IMPORT-DEPENDENT CANADA UNDER THE COMPENSATION/
SUBSIDY PROGRAM WHICH OPERATES TO EQUALIZE (EXCEPT FOR
TRANSPORTATION COST DIFFERENTIALS) THE PRICE OF
PETROLEUM PRODUCTS NATIONWIDE. THE INCREASING BURDEN
OF THE COMPENSATION/SUBSIDY PROGRAM MAY BE ONE OF THE
PRIMARY REASONS WHY THE FEDERAL GOVERNMENT APPEARS TO BE
ADAMANT THAT DOMESTIC OIL PRICES MUST INCREASE: WITH
FALLING EXPORTS TO THE U.S. AND THE CONCOMITANT DECREASE
IN EXPORT CHARGE REVENUES, THE PROGRAM FOR SUBSIDIZING
AN INCREASING VOLUME OF WORLD-MARKET PRICE IMPORTS INTO
EASTERN CANADA WILL PLACE AN EVER-GROWING DEMAND UPON
GENERAL REVENUES; THE SMALLER THE DIFFERENCE BETWEEN
DOMESTIC AND WORLD PRICES, THE SMALLER THE FISCAL
BURDEN WILL BE.

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P 172010Z APR 75

FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC PRIORITY 6172

C O N F I D E N T I A L SECTION 2 OF 2 OTTAWA 1394

5. IN THE PARTICULAR CASE OF SASKATCHEWAN, OTTAWA
(ENERGY MINISTER MACDONALD SPECIFICALLY) RECOGNIZED
THAT THE PROVINCE'S LESS ATTRACTIVE HEAVY OILS HAVE
NEVER BEEN PARTICULARLY SALEABLE IN CANADA AND THAT
EVEN THE PRESENT LOWER EXPORT CHARGES PLACED ON THEM
(AS OPPOSED TO ALBERTAN OILS) ARE STILL TOO HIGH FOR
THE U.S. MARKET. EMBASSY WOULD CONSEQUENTLY EXPECT
A FURTHER DOWNWARD ADJUSTMENT IN THE EXPORT CHARGE

ON THESE OILS IN COMING WEEKS.

6. NATURAL GAS: AS PREMIER LOGHEED WAS AT PAINS TO EMPHASIZE, A NATURAL GAS SUPPLY CRUNCH MAY, SUPRISINGLY, BE MORE IMMINENT THAN AN OIL CRUNCH. HE CITED A SERIOUS POTENTIAL SHORTAGE FOR ONTARIO USERS WITHIN THREE YEARS. TO THIS POINT, ENERGY MINISTER MACDONALD STATED THAT HE WOULD WISH TO MEET "URGENTLY" WITH THE MAJOR GAS CONSUMING PROVINCES OF ONTARIO, QUEBEC, MANITOBA, AND SASKATCHEWAN TO DISCUSS POSSIBLE CURTAILMENT OF ALLOCATIONS AMONG THEIR GAS CUSTOMERS. TO THE EMBASSY'S BEST RECOLLECTION, THIS IS THE FIRST TIME MACDONALD OR ANY OTHER GOC OFFICIAL HAS MENTIONED "CURTAILMENT" ON THE CANADIAN SIDE OF THE BORDER. EMBASSY WOULD
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EMPHASIZE, HOWEVER, THAT THIS SHOULD NOT RPT NOT BE TAKEN TO SIGNIFY ANY CHANGE IN THE BASIC CANADIAN POLICY THAT, WHERE TECHNICALLY FEASIBLE, CANADIAN NEEDS MUST BE MET FIRST AND, IMPLICITLY, THAT U.S. CUSTOMERS MUST ACCEPT THE FULL BURDEN OF ANY SUPPLY SHORTFALLS REGARDLESS OF LONG-TERM SUPPLY CONTRACTS.

7. IT WAS ALSO APPARENT AT THE CONFERENCE THAT, BECAUSE THE GAP BETWEEN NATURAL GAS AND OIL PRICES ON A BTU-EQUIVALENT BASIS IS SO LARGE EVEN AT PRESENT OIL PRICES, THE PRICE OF NATURAL GAS WILL RISE SHARPLY FOR CANADIANS OVER THE NEXT SEVERAL YEARS AND EVEN MORE RAPIDLY FOR U.S. CUSTOMERS, PERHAPS TO AS HIGH AS \$1.50 TO \$1.60 PER MCF BY AUGUST 1, WITH PREMIER BARRETT CLAIMING A "FAIR" PRICE FOR THE U.S. OF \$2.00 PER MCF BY NOVEMBER 1. THERE WAS NO RPT NO INDUCATION IN THE PUBLIC ESSIONS OF THE CONFERENCE, HOWEVER, WHEN THE HIGHER EXPORT AND DOMESTIC PRICES MIGHT CONVERGE ALTHOUGH THIS IS THE GOC'S LONG-RUN OBJECTIVE.

8. IN SUM, THE U.S. SHOULD ASSUME A POSSIBLE INCREASE IN NATURAL GAS EXPORT PRICES OF APPROXIMATELY 50 PERCENT BEFORE THE YEAR IS OUT; THIS WOULD IMPLY A TOTAL ADDITIONAL COST OF ROUGHLY \$500 MILLION YEARLY IF PRESENT EXPORT VOLUMES ARE MAINTAINED, A CONDITION WHICH MAY NOT HOLD IN THE PROBABLE CASE THAT SOME CURTAILMENT IN EXPORTS IS RECOMMENDED BY THE NATIONAL ENERGY BOARD AND AFFIRMED BY THE GOVERNMENT. WHILE THE GOC MAY OPT FOR AT LEAST SOME FORM OF PRO-RATA CURTAILMENT ON SUPPLIES FOR BOTH SIDES OF THE BORDER TO EASE U.S. SENSITIVITIES, TO HEED U.S. WARNINGS OF DRASTIC ACTION IF THIS DOES NOT OCCUR, AND TO SOFTEN THE BLOW OF THE HIGHER PRICES, PROSPECTS OF THIS ARE HIGHLY UNCERTAIN AT BEST.

9. ON THE OIL SIDE, WE CAN FORESEE SOME EASING OF THE PRICE SITUATION REGARDING THE RELATIVELY UNIMPORTANT SASKATCHEWAN OILS BUT ARE CONCERNED ABOUT WHETHER EXPORT ALLOCATIONS WILL BE MAINTAINED AT THE 800,000 B/D LEVEL BEYOND JULY 1. AS MACDONALD POINTED OUT AT THE CONFERENCE, U.S. IMPORTS IN APRIL WERE ALREADY
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BELOW 650,000 B/D (SEE OTTAWA 1248). THIS SHOULD MAKE IT EASIER FOR MACDONALD TO SECURE AGREEMENT FROM THE PRODUCING PROVINCES TO OFFICIALLY LOWER THE EXPORT CAILING TO 650,000 B/D ON JULY 1 AS HE ORIGINALLY PROPOSED LAST NOVEMBER.

10. THE U.S. SHOULD ALSO NOTE THE UNFAVORABLE IMPACT HIGHER DOMESTIC OIL AND GAS PRICES WOULD HAVE ON CANADIAN INDUSTRY COMPETITIVENESS IN THE U.S. MARKET (A POINT STRONGLY MADE BY ONTARIO'S PREMIER DAVIS AT THE CONFERENCE). SUCH AN IMPACT WOULD BE ADDITIONAL TO RECENT CANADIAN CONCERN OVER MUCH HIGHER UNIT LABOR COSTS IN CANADA AND THEEROSION OF CANADA'S COMPETITIVE POSITION IN EXPORT MARKETS AS COSTS RISE FASTER THAN IN THE U.S. (SEE OTTAWA'S 1342 OF APRIL 11.) SOME INDUSTRIAL SECTORS (TEXTILES, ELECTRONICS, AUTOMOTIVE PARTS) ARE ALREADY MOUNTING PROTECTIONIST CAMPAIGNS AND ANY FURTHER DETERIORATION IN CANADIAN INDUSTRY'S COMPETITIVE POSITION WOULD LIKELY GENERATE INCREASED PRESSURES FOR CORRECTIVE ACTION. AT THE LEAST, THE NON-OIL AND GAS PRODUCING PROVINCES (PARTICULARLY QUEBEC AND ONTARIO) FEAR THAT ENERGY PRICE INCREASES AT THIS TIME WILL DELAY CANADIAN ECONOMIC RECOVERY.
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